

CORRECTED FISCAL NOTE

SB 406 - HB 1071

March 28, 2007

SUMMARY OF BILL: Enacts the "Health Care Assistance Act of 2007," effective July 1, 2007. Increases the excise tax on cigarettes from 20 cents to 80 cents per pack. Increases the excise tax on cigarettes by 1 cent per pack each fiscal year beginning with FY07-08 and continuing until FY17-18. Creates within the state treasury a "Health Care Assistance Account (HCAA)." All funds generated from such excise tax increases shall be earmarked for deposit to the HCAA.

ESTIMATED FISCAL IMPACT:

On February 12, 2007, we issued a fiscal note for this bill with the following estimated fiscal impact:

Increase State Revenues:

\$311,570,000 / Health Care Assistance Account
\$3,286,000 / General Fund
\$7,370,000 / Education Fund
\$42,000 / Department of Revenue
<u>\$104,000 / Sinking Fund</u>
\$322,372,000 – Total Revenue Increase

Increase State Expenditures - \$420,000 One-Time

Increase Local Govt. Revenues - \$4,159,000

Based on new information, the fiscal impact of this bill is estimated as follows:

(CORRECTED)

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\$42,000 / Department of Revenue
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\$322,372,000 – Total Revenue Increase

SB 406 - HB 1071 (CORRECTED)

**Increase State Expenditures - \$220,000 Recurring
\$75,000 One-Time**

Increase Local Govt. Revenues - \$4,159,000

Cigarette Tax Assumptions:

- According to the DOR, excise tax collections on cigarettes in FY05-06 were approximately \$115,462,000.
- Current excise tax rate on cigarettes is \$0.20 per pack.
- Estimated number of packs sold in FY05-06 was 577,310,000 ($\$115,462,000 \div \$0.20 = 577,310,000$ packs).
- Cigarette elasticity is determined from a variable elasticity schedule depending upon the extent of any excise tax increase.
- Cigarette elasticity rate for proposed increase is estimated to be -0.452
- Current state sales tax rate on cigarettes is 7.00%.
- Local option sales tax rate on cigarettes is estimated to be 2.25%.
- Current consumer price per pack is estimated to be \$3.19 per pack (excluding sales tax); \$3.49 per pack (including sales tax).
- Increasing the excise tax on cigarettes by \$0.61 per pack (\$0.60 one-time + \$0.01 annual = \$0.61 increase in FY07-08) would also generate an additional \$0.06 per pack in state and local option sales tax revenue ($\$0.61 \times 9.25\% = \0.056).
- The total price increase to the consumer is estimated to be \$0.67 per pack ($\0.61 excise tax increase + $\$0.06$ incremental sales tax = $\$0.67$).
- Consumer price per pack after the proposed excise tax increase is estimated to be \$3.80 per pack (excluding sales tax); \$4.16 per pack (including sales tax).
- Increasing the excise tax on cigarettes would increase the price per pack to the consumer by an estimated 19.2% ($\$0.67 \div \$3.49 = 19.2\%$).
- Quantity demanded would decrease by an estimated 8.68% (19.2% price increase $\times -0.452$ elasticity rate = -8.68%).
- Quantity demanded in FY07-08 is estimated to be 527,199,492 packs ($577,310,000 \times \{100.00\% - 8.68\%\} = 527,199,492$).
- Total excise tax collections are estimated to be \$427,032,000 ($527,199,492$ packs $\times \$0.81$ excise tax = $\$427,031,589$) in FY07-08.
- Incremental excise tax collections are estimated to be \$311,570,000 ($\$427,032,000 - \$115,462,000 = \$311,570,000$) per year.
- 100% of the estimated \$311,570,000 in incremental excise tax collections would be apportioned exclusively for the new HCAA.
- Excise tax collections would grow in subsequent fiscal years due to the additional excise tax rate increases proposed in this legislation.

- Sales tax collections will increase because sales tax is computed on the final retail sale (which includes any current and increased excise tax).
- Retail sales before the proposed excise tax increase are estimated to be \$1,841,619,000 (577,310,000 packs X \$3.19 old price (excluding sales tax) = \$1,841,618,900).
- Retail sales after the proposed excise tax increase are estimated to be \$2,003,358,000 (527,199,492 packs X \$3.80 new price (excluding sales tax) = \$2,003,358,070).
- Incremental retail sales are estimated to be \$161,739,000 (\$2,003,358,000 - \$1,841,619,000 = \$161,739,000).
- Incremental state sales tax revenue is estimated to be \$11,322,000 (\$161,739,000 X 7% state rate = \$11,321,730) per year.
- The \$11,322,000 in incremental state sales tax revenue would be apportioned as follows: \$3,286,000 to the General Fund, \$7,370,000 to education, \$520,000 to local governments, \$42,000 to the DOR, and \$104,000 to the Sinking Fund.
- The net recurring increase to state revenues resulting from incremental state sales tax collections is estimated to be \$10,802,000 (\$11,322,000 - \$520,000 local share = \$10,802,000) per year.
- Additional sales tax revenue will result (for both state and local governments) in subsequent fiscal years due to the additional excise tax rate increases proposed in this legislation.
- The total net recurring increase to state revenues resulting from the increased excise tax is estimated to be \$322,372,000 (\$311,570,000 from additional excise tax + \$10,802,000 from additional sales tax = \$322,372,000) per year.
- Incremental local option sales tax revenue is estimated to be \$3,639,000 (\$161,739,000 X 2.25% local option rate = \$3,639,128).
- The total net recurring increase to local government revenues resulting from the increased excise tax is estimated to be \$4,159,000 (\$3,639,000 in local option tax revenue + \$520,000 in state-shared sales tax revenue = \$4,159,000).

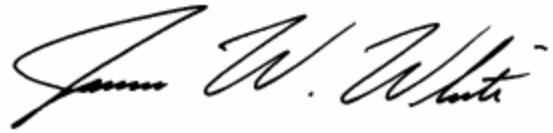
Other Assumptions:

- Three additional Regulatory Officers in the DOR will be required to combat the illegal importation of cigarettes into Tennessee.
- Security upgrades will be required for cigarette tax stamps to combat illegal/counterfeit tax stamps.
- The recurring increase to state expenditures for the new positions and tax stamp enhancements is estimated to be \$220,000 per year.
- The one-time increase to state expenditures for costs associated with hiring the three Regulatory Officers is estimated to be \$75,000.
- It is the legislative intent that the fiscal impact of this bill be as revenue-neutral as practicable in the immediate and long-term. However, this

legislation as proposed includes no language that reduces tax elsewhere to achieve the revenue-neutral intent.

CERTIFICATION:

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.

A handwritten signature in black ink, reading "James W. White". The signature is written in a cursive style with a large, stylized "J" and "W".

James W. White, Executive Director